

Dorothy Robyn
Special Assistant to the President
for Economic Policy National Economic Council

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In February 1993, on his first trip outside of Washington, DC, President Clinton traveled to a Boeing plant near Seattle to meet with airline leaders about the economic crisis gripping their industry. Out of that meeting came the Commission to Ensure a Strong Competitive Airline Industry. As that early trip reflected, the President felt that the recovery of the airline industry was key to the recovery of the economy overall.

Seven years later, the airline industry is strong and, if anything, it has become even more important to the health of our economy. Which is why the industry remains a high priority to the Administration.

To promote aviation, the Administration has followed a three-part strategy. One, preserve and enhance domestic competition, so that Americans continue to reap the benefits of airline deregulation. Two, open foreign markets, so that U.S. airlines can compete and win internationally. And three, improve the efficiency of our aviation infrastructure to keep pace with the phenomenal growth in air travel.

Let me discuss the first two briefly and then talk about the third in more detail.

Promoting Domestic Competition. Our first goal has been to preserve and enhance domestic competition. Deregulation of the airline industry continues to be a resounding success for the vast majority of American consumers:

Since 1978, average fares have dropped 35-40% (adjusted for inflation), daily departures have more than doubled, and the number of passengers has more than tripled. Economists estimate that airline deregulation brings consumers \$20 billion a year in savings.

Low-fare carriers, particularly Southwest Airlines, have played a particularly important role, both directly, and indirectly, by spurring the major carriers to offer low fares as well.

Airline deregulation was, in many respects, a triumph of economics over politics. Economists first championed the idea in academic journals. They joined the government to push for it from the inside. And with President Carter's strong support, they succeeded in making it law, despite the opposition of most major stakeholders.

In this respect, airline deregulation (like trucking deregulation, which followed by a year) is an exception to "Murphy's Law of Economic Policy." Murphy's Law of Economic Policy, formulated by Princeton economist Alan Blinder, says that "Economists have the least influence on policy where they know the most and are most agreed. They have the most influence on policy where they know the least and disagree most vehemently." It is a rather cynical observation but often true, and it is a theme I will return to.

To maintain the benefits of deregulation, the Administration has tried to enhance competition in a number of ways. Let me mention the most important.

- We pushed to eliminate the slot rule at LaGuardia, JFK and O'Hare, which Congress agreed to this year as part of the FAA reauthorization bill, FAIR-21; the immediate statutory exemption for RJs and new carriers is already promising benefits to underserved areas.
- We supported an increase in the Passenger Facility Charge (PFC), which is also in FAIR-21, so that airports could add needed facilities, and in other ways encouraged airports to provide access to new entrant carriers.
- We have supported enforcement of the antitrust laws: The Antitrust Division has sued American Airlines for monopolizing its Dallas hub, and challenged Northwest's acquisition of a controlling interest in Continental. The Antitrust Division is currently reviewing the proposed merger of United Airlines and US Airways.
- And DOT is continuing to review its proposed competition guidelines, based on thousands of comments it received.

Last July, a blue-ribbon panel convened by the National Academy of Sciences' Transportation Research Board (TRB) concluded that the guidelines as proposed were flawed, although the members were divided on the broader question: Should DOT have a role in regulating predatory pricing or should all predatory conduct be subject only to enforcement of the antitrust laws? (I'll say more about the TRB panel later.)

Recent discussion about airline competition has focused largely on the issue of consolidation. Let me say at the start that the White House does not comment on, or in any way get involved in, individual merger transactions while they are under review by the Antitrust Division or the FTC. Few other countries have that strict separation between political officials and competition authorities.

That said, to do my job, I have to understand something of the competitive structure of the airline industry. In recent months, I have repeatedly heard or read statements to the effect that the airline industry is a "mature industry," like steel or autos, and would therefore necessarily be more efficient — and no less competitive — with just a few big players. Setting aside the merits of any particular merger, I want to play devil's advocate regarding the assumption that massive consolidation is either inevitable or desirable.

First, because regulatory barriers to geographic expansion in the U.S. disappeared long ago, most major airlines have pretty well exhausted the economies of density of their hub-and-spoke networks. More generally, financial success in the airline industry appears to stem from a combination of factors, few of which have anything to do with size. Finally, airlines are notoriously hard to merge, because of the difficulties of combining union lists, fleets and other assets. For all of these reasons, one should question whether a massive consolidation would produce corresponding efficiency gains.

Balanced against the prospect of greater efficiencies from massive consolidation is the risk of reduced competition, particularly for business travelers. Because the major airlines have the high frequencies and broad geographic scope that corporate travelers value, they are the principal competitors for their business. Corporations rely on competition among the majors to get the best deal (often in the form of an exclusive contract with one airline that provides for significant discounts). If consolidation were to eliminate all but a few major airlines, many corporations would have fewer alternatives for air travel.

In sum, airline consolidation, unlike airline deregulation, is an issue about which economists do not all think alike. To be sure, individual mergers may make sense. But a massive consolidation, at the very least, would be highly controversial.

Opening Foreign Markets. The second plank in the Administration's aviation policy has been to open foreign markets. Since 1993, and working closely with industry, we have negotiated Open Skies Agreements with 45 countries (15 of them in Europe), and the result has been significantly increased traffic, lower prices and more service options.

Still, there's a lot left to do. At the top of our list is Bermuda 2, the highly restrictive bilateral agreement between the U.S. and the UK that limits access to Heathrow, the world's biggest and most lucrative international hub, to a small club of airlines known as the Heathrow Four. Bermuda 2 is an anomaly in the otherwise strong economic relationship between the United States and Britain, two of the staunchest free-trading countries on earth.

Let me reiterate what Secretary Slater said on Friday, in reference to a possible merger between British Airways and KLM. The U.S. will not allow British Airways to use a merger with KLM as a "back door" to achieve greater access to our market. Moreover, if KLM comes under effective control of British Airways while Bermuda 2 still governs US-UK air services, KLM will immediately lose the benefits of the US-Netherlands Open Skies Agreement. KLM's chief executive, Leo van Wijk, appeared to acknowledge that in a statement in Friday's *Financial Times*. He said "a US-UK open skies agreement is a prerequisite" for a merger deal between KLM and British Airways.

Let me also say for the record that the United States has no interest in any kind of "mini-deal" with the UK. A mini-deal would only serve as a "steam valve" to ease the growing pressure on the UK government for full liberalization. That is not in our interest.

Improving the Efficiency of Aviation Infrastructure. The Administration's third goal has been to improve the efficiency of our aviation infrastructure — particularly the air traffic control system. The Vice President made this issue a priority for the Administration early on, and we have made significant progress working with the Congress. But it has not been nearly enough, as the horrendous delay statistics demonstrate.

I want to argue today that this is a "predictable predicament." It reflects a mismatch between the nature of the services — both air traffic control and airport landing services — and the way we provide those services. The predicament also illustrates

Murphy's Law of Economic Policy. Economists know how to fix it, at least in part, but no one is listening. Let me talk about predicament we're in and the (partial) fix that only economists want to discuss.

Let me start by saying that the FAA is an extraordinary organization, and the team at the top is as good as they get. Jane Garvey and David Traynham and the thousands of dedicated controllers and engineers who work for the FAA operate the largest, busiest and safest air travel system in the world. They orchestrate 100,000 flights a day — more than one every second. They also oversee the safety of the entire system, which has an exceptional record.

But despite the efforts of these talented people, the rapid growth in air travel is bumping up against the limits of the FAA's aging infrastructure. Flight delays in the last five years have increased by 50%, cancellations by 130%. The cost to airlines and passengers is more than \$5 billion a year, according to the ATA. And these statistics understate the real costs, because airlines increasingly "pad" their published schedules to accommodate routine delays.

Moreover, delays are almost certain to get worse. One reason is traffic growth. The FAA predicts a 50% increase in passengers and a doubling of cargo by 2010. Reason two is regional jets, which fly at the same altitude as larger planes but not as fast. With several hundred RJs coming into the fleet each year, these popular planes will be a growing source of delays.

Ultimately, new technology will expand the amount of available air space, through the use of "free flight," curved approaches to landings, and other technological innovations. But modernization of our air traffic control system is a long-term effort, even though the FAA's new, more incremental approach to modernization is providing near-term benefits.

If delays are the symptom, the underlying problem is that the FAA, as a traditional government agency, is not structured to manage a high-tech operational service like air traffic control. It is a command-and-control regulatory organization that is constrained by federal budget rules and subject to detailed oversight from Congress and the Executive Branch. This environment is poorly suited to operating an ATC system that has many of the features of a business.

The last point is key: in fundamental respects, the ATC system is more like a commercial business than a typical government activity.

First, ATC activities are purely operational. Although air traffic control must be regulated for safety, most experts agree that the operational activities are distinct and separable from the regulatory oversight.

Second, precisely because ATC is purely operational, the mission of an ATC service provider is clear and its performance is measurable.

Third, the direct customers of the ATC system — commercial airlines and general aviation — are identifiable, and most of the benefits and costs of ATC services accrue to those who are already paying the costs.

Because ATC has these fundamental characteristics, more than 20 countries have entrusted its provision to autonomous, not-for-profit organizations that are outside of the traditional government bureaucracy and that possess a degree of commercial freedom (e.g., the ability to borrow on capital markets free of government borrowing limits).

In 1993, the Vice President called for moving the FAA's air traffic control operation into an independent government corporation, so that it could use many of the tools available to the private sector to provide services more efficiently. In the words of his National Performance Review:

America needs one seamless air traffic control system from coast to coast — able to borrow on capital markets, to do long-term financial planning, to buy the equipment it needs when it needs it, and to hire and fire in a reasonable fashion.

In 1995, the Administration followed up with legislation to create a not-for-profit government corporation — the U.S. Air Traffic Services Corporation (USATS) — which would be governed by a board of directors and a chief executive officer, and financed with cost-based charges on commercial airlines (general aviation was exempt). The FAA would continue to regulate safety.

USATS was dead on arrival in Congress. Some Members felt it went too far, others not far enough. The one thing everyone agreed on was that they didn't like our user fee proposal — in large part because it was contained in an Administration budget plan that eliminated the \$2 billion general fund contribution to the FAA.

Although Congress rejected USATS, it subsequently adopted key elements of our proposal, such as acquisition and personnel reform. This year's FAA authorization bill adopted still more reforms, some from our 1998 proposal to make ATC a performance-based organization within the FAA. FAIR-21 creates a five-member Air Traffic Services Subcommittee, comparable to a board of directors; and it establishes the position of Chief Operating Officer for air traffic services.

As important as these reforms are, they will not be enough.

What FAIR-21 did not do was alter the mechanism for financing air traffic control. Under the current mechanism, the ticket tax on passengers, there is no necessary correlation between what users pay and the services they use. To remedy this, the Administration and the National Civil Aviation Review Commission both urged Congress to replace the ticket tax with cost-based charges on commercial airlines; general aviation would continue to pay a fuel tax. We argued that the ATC system must have the ability to price its services, in order to balance supply and demand in the short run and know how to meet customer demand in the long run.

The current approach leads to inefficiencies in both the provision and the use of air traffic control.

First, consider the provision of ATC. Unlike a commercial firm that charges customers for its products, the FAA cannot compare its costs and revenues in order to learn how customers value its various services, where it needs to reduce costs, which particular services to develop or improve, or where to invest new capital.

To illustrate, NCARC faults the FAA for focusing its investments on items that would allow the agency to reduce its costs, while ignoring potential investments that would provide more and better services to commercial airlines and other users. Why this bias? For the simple reason that the FAA has no way to charge commercial airlines for those new services.

If the provision of ATC is inefficient, so too is its consumption. Reliance on the ticket tax means that airlines pay for ATC services indirectly, rather than directly. As with any free good, users consume more of it than if they had to pay for it. This takes the form of airlines scheduling more frequent flights on smaller planes. It also takes the form of airlines all wanting to fly in the most expensive airspace.

To illustrate, United and American Airlines recently agreed to have some of their short-distance flights use lower-altitude flight paths out of O'Hare. Until recently, the major airlines resisted lower-altitude flights because the thicker air creates more drag, which requires more fuel. But because of the long delays to get an open flight path at the higher altitude, the two airlines have finally decided to incur the additional fuel costs. If the FAA could charge market prices for use of the airways, lower-altitude air space would be less expensive and airlines would have an economic incentive to use it, even before delays reach the breaking point. But without pricing, everyone's incentive is to use the most costly airspace.

Airport landing systems face the same problem. They operate on a first-come, first-served basis, and landing fees, which rarely cover more than wear and tear on runways, do not rise during peak periods. Thus, they provide little incentive for low-value users to shift activity to less congested airports or off-peak hours. This guarantees a chronic mismatch between demand and supply, accompanied by congestion and delays.

For example, United offers 38 flights a day from Los Angeles to San Francisco, most on Boeing 737s. The frequent flights are a logical competitive response to Southwest, which offers similar service from LA to Oakland. Recently, the San Francisco Airport, which has a terrible congestion problem because of frequent fog, asked the FAA to require United to offer fewer flights using larger aircraft. United eventually reached a voluntary agreement with the airport. But if the airport had used congestion pricing, it could have achieved the same result with a lot less hassle.

If pricing of airspace and airports seems arcane, consider that it was the major recommendation that came out of last summer's TRB report. The panel of all-star economists and other aviation experts concluded that "Chronic air traffic delays are not only indicative of demand that is stressing insufficient capacity, but also of an inefficient means of rationing infrastructure use."

While airport runway expansions and air traffic control modernization could increase capacity, it is important to take advantage of the underutilized parts of the system. For instance, secondary airports in many major metropolitan areas have idle capacity, and even many hubs have extra capacity between connecting banks. Regarding this as an opportunity, Southwest Airlines concentrates its operations at secondary airports and during lulls in hubbing activity at the primary airports where it chooses to operate. Given the expense and practical difficulties of expanding runways and terminals at many congested, major airports - partly because of limited space and community opposition to noise - the importance of using existing capacity more intensively and wisely is apparent.

Other recent economic studies of aviation have likewise concluded that the industry's primary inefficiencies stem from government management of airport and airspace capacity, which limits competition and compromises service.

In short, the leading economists in the country have concluded that pricing of ATC and airports is perhaps the single most important thing the federal government could do to promote competition in aviation, improve service and reduce congestion. And yet this idea is not even under serious debate here in Washington. You are seeing Murphy's Law of Economic Policy in action.

I will not go through the litany of arguments made for why we should not price airspace and airports. Suffice it to say there is considerable fear of the unknown and concern by some that change will make them worse off. These concerns are legitimate issues for debate. But we should deal with them as part of a serious debate about pricing rather than avoiding the debate altogether.

Conclusion. Seven years after the Commission to Ensure a Strong Competitive Airline Industry, U.S. airlines are strong and competitive, reflecting an unflagging economy and the continued success of airline deregulation. However, all of this good news has stretched the capacity of our aviation infrastructure nearly to the limit.

The Congress and the Administration have made significant progress: Acquisition and personnel reform. A near-complete comprehensive cost accounting system. The Spring/Summer 2000 Plan and the extraordinary partnership it represents. And the excellent provisions in FAIR-21 on slot controls and air traffic control governance.

But we still use a system for allocating airspace and airports that was designed for the pre-1978 era, when government decided which markets carriers could serve and what prices they could charge. While airlines have developed the most sophisticated pricing models of any industry, we have not introduced basic market-based pricing for allocating air traffic control and airports. The predictable result is congestion, delays and unhappy passengers.

We can continue on our current course until our air travel system is significantly compromised by its infrastructure. Or we can take the advice of the people who fought to bring us airline deregulation. John Meyer, the legendary transportation economist who chaired the TRB panel on aviation, said it best in a recent article that summed up the work of that group:

The laggard performance of the public sector in allowing more efficient development and use of critical aviation infrastructure is a serious deficiency that will become more troublesome as air travel expands. Crowded airports, flight delays and passenger discontent over fares and services should not be seen as shortcomings of deregulation — but rather as clarion calls to complete the deregulation process by instilling market incentives wherever sensible and feasible.